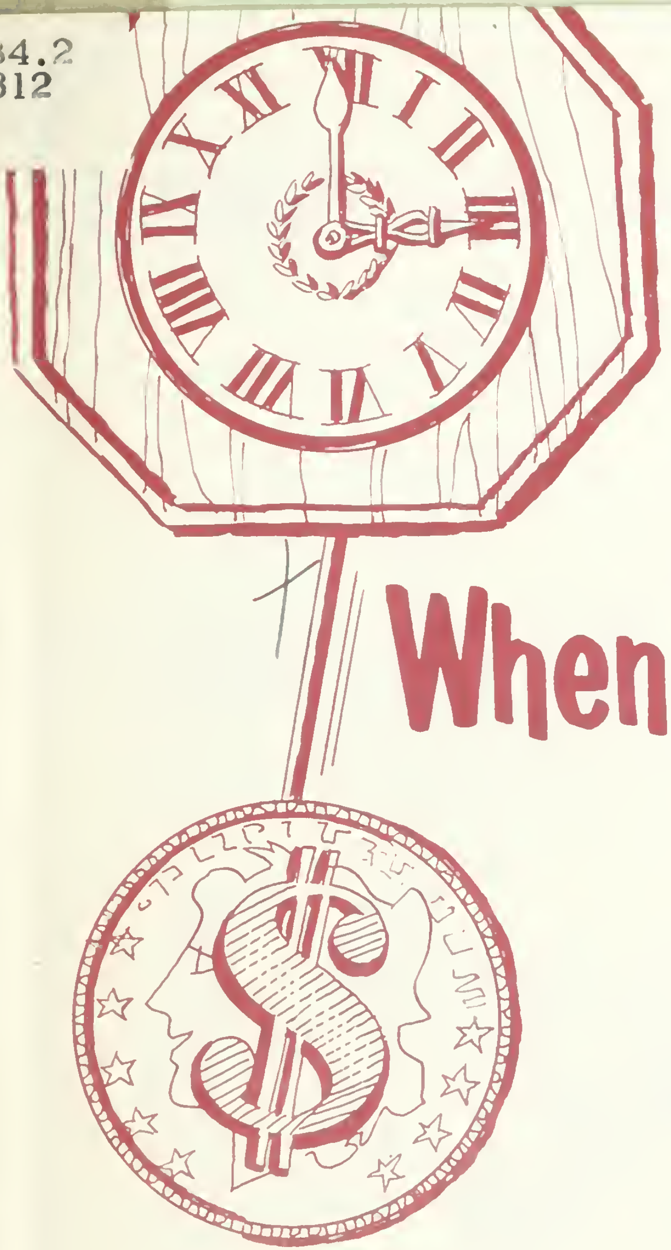

When You Use CREDIT

--for the family

JANUARY 1965 * DIVISION OF HOME ECONOMICS * FEDERAL EXTENSION SERVICE * U. S. DEPARTMENT OF AGRICULTURE

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When You Use CREDIT

When you do not have money for the things you want and need, you may say—

we'll "charge it."
we'll "finance it."
we'll buy it "on time."
we'll use a "payment plan."

This means you will use credit. To buy on credit means you buy now, pay later. You can use the goods while you pay. Usually you will pay every week or every month. Shop around before you decide what kind and how much credit to use. You need to know the kinds of credit and how much each costs.

Credit can be dangerous if you use it wrongly. Use it *carefully* and *wisely*.

Reasons for and Against Credit

Reasons "For"	Reasons "Against"
It's convenient.	It's expensive.
You can use things while paying for them.	You may overspend.
You get better service.	You may not shop around as much.
It's handy in emergencies.	It's hard to understand.

Words Used in Discussing Credit

Before you borrow money or sign a credit contract, be sure you understand the words used. If you do not understand, ask for an explanation. Words used most often are—

BALANCE—the amount you still owe on an account at any given time.

BORROWER—the person who buys something on time or borrows cash.

COLLATERAL—the property put up to "secure" a loan. If the loan isn't paid, the lender may get the property.

CONTRACT—usually a written agreement that says how you will pay.

CREDIT—buying things and paying later, or borrowing money and paying later.

CREDIT CHARGE—is mainly interest but includes other charges such as cost of bookkeeping and investigation.

CREDIT RATE—the percentage that the credit charge bears to the average principal amount.

CREDITOR OR LENDER—the person, store, firm, bank, credit union, or other organization that lends money, or sells things or services "on time."

DEFAULT—failure to pay when due. Also failure to meet any terms of the contract.

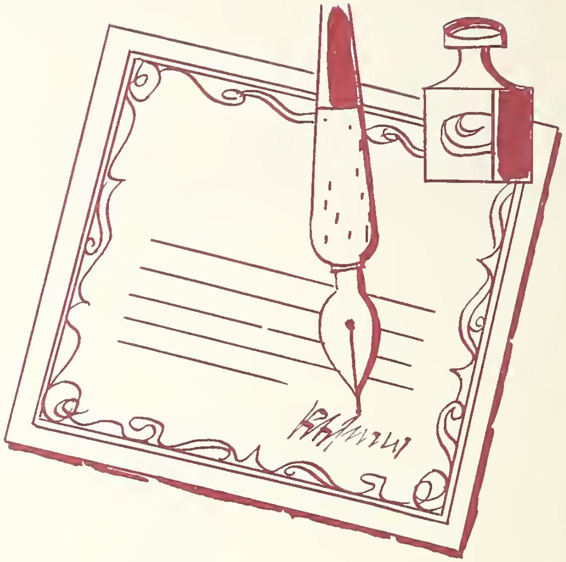
INSTALLMENT—one of a series of payments to pay off a debt.

INTEREST—how much you pay to use borrowed money.

PRINCIPAL—the amount you borrow or finance.

REPOSSESSION—the seller takes back goods when the buyer fails to meet payments.

Understand Your Contract



If you buy things "on time" or borrow money, you usually sign a paper called a contract. Contracts are legal documents. You are responsible for what you sign.

When you buy something "on time" you agree:

- to make payments to repay your debt.
- you do not own what you bought until you make all payments.
- not to sell or move what you've bought until you have paid for it.
- to take care of any loss or damage to it.
- if you fail to make payments, the creditor can take back what you've bought.

When you borrow money you agree to repay the money.

Never Sign a Blank Contract

Read and understand the contract. Take plenty of time. Know what happens if you can't pay. Check the contract for each amount, date, and other terms. Be sure they are filled in before you sign. Be sure to get a copy of what you sign. Look out for a contract with a final payment much larger than all the others.

Make sure the contract states clearly:

- purchase price, or amount borrowed
- interest and service charges *in dollars*
- down payment
- trade-in allowance
- insurance charges
- any other costs or service charges
- total amount due
- amount of each payment
- number of payments
- date each payment is due.

Can You Afford to Use Credit?

Credit has become easier and easier to get. Merchants have found that it increases their business. People return to stores where they can charge things. It's easy to buy more than you can pay for.

Questions to Ask Yourself When YOU USE CREDIT—

- is having something now worth the extra cost?
- do you need it now?
- what will you gain from it?
- can you meet the payments?
- is it worth the risk?
- will it help you make more money?
- what will you give up while paying for it?
- are you paying too much in interest and carrying charges?
- are you dealing with a fair and honest lender?

TO DECIDE WHETHER TO BUY ON CREDIT:

Figure out how much money is coming in for a week, a month, a year. List the money you are sure will come in. Don't include overtime pay or money in short term jobs.

Add up all your expenses. List everything you can think of. Don't skimp. Estimate high costs rather than low. Include things such as food, clothing, housing, Federal and State taxes, and present installment payments.

If you keep a spending plan, you already know what you have spent. This could guide you in planning for the future.

Now subtract the amount of money you plan to spend from the amount you expect to make.

How much is left? This is the amount you have for savings, emergencies, and additional installment payments.

Your family needs to decide if they should—

- save the money and buy later, or
- use credit and buy the item now.

Your decision will depend on how badly you want and need this item.

Use Credit Wisely

When you use credit, remember:

1. Make as large a downpayment as possible. Your payments will be less.
2. Pay the balance as quickly as you can. You will save money.
3. Your credit rating is valuable. Protect it. Use credit only for things you really want and need.

How Credit Costs are Figured

The cost of credit depends on:

- who you borrow from
- amount of money you borrow
- length of time you borrow it
- your ability to repay
- risk the creditor takes
- what collateral or security you can offer
- your reputation for paying bills

Charges made for credit are stated:

- in dollars and cents
- as a percentage rate

HOW TO FIGURE THE DOLLAR COST OF CREDIT

To figure the dollar cost of credit—

- add all costs
- subtract the cash price of what you are buying or the money you actually get from the lender. The difference will be your dollar cost for using credit.

For example, you buy an item that costs $310. You make a down payment of $35. You agree to make 18 monthly payments of $17.50.

Figure the dollar cost as shown below:

18 monthly payments at $17.50 each	$315.00
Add down payment at the time of purchase	35.00
Total cost of item	$350.00
Subtract cash price of item	310.00
How much it costs you to use credit	$ 40.00

HOW TO FIGURE CREDIT RATES

If you are going to borrow money, or buy on credit, you need to know how to figure the rate. Then you can compare the rates to decide where to borrow. Interest and finance rates are stated in many ways. This is confusing to most people.

Following is a method to figure annual rates using the case above.

Step 1. Multiply 2 times the dollar cost of credit ($40).

40 x 2 = 80

Step 2. Multiply this (80) by the number of payments in a year (12).

80 x 12 = 960

Step 3. Multiply the amount of credit needed ($310 cost of item less $35 down payment)—$275—by the total number of payments (18) plus 1.

18 + 1 = 19

275 x 19 = 5225

Step 4. Divide the results in Step 2 (960) by the results in Step 3 (5225). The answer is your true annual credit rate—18.37%.

$$\begin{array}{r} .1837+ \\ 5225\overline{)960.000} \\ 5225 \\ \hline 43750 \\ 41800 \\ \hline 19500 \\ 15675 \\ \hline 38250 \end{array} = 18.37\%$$

Ways of Stating Interest

SIMPLE INTEREST

Simple interest at 6 percent means you pay 6 cents on each dollar for one year. It usually applies to a single payment loan payable once a year. The loan and interest are paid at one time.
Six percent interest on $100 for a year equals $6.00 interest.

You may pay a part or all of the loan ahead of time. Then the interest you owe will be adjusted. You may pay the loan in one lump sum in 6 months. Then your interest would be one-half of $6.00 or $3.00.

INTEREST ON UNPAID BALANCE

Here you make payments on the amount borrowed. The size of the loan gets smaller. Interest is figured on the unpaid balance. This is the amount you actually owe at any given time.
Here is how to figure interest at 1 percent per month on the unpaid balance of a $100 loan to be paid in 12 monthly payments:

Step 1. Divide $100 by 12. This gives the amount you pay on the principal each month, which is $8.33.

Step 2. Figure the interest on $100 at 1 percent. This is $1.00. The first month you will pay $8.33 plus interest, which is a total of $9.33.

Step 3. Each month subtract $8.33 from the principal left at the end of the previous month.
For example: $100—$8.33=$91.67

Step 4. Figure the interest on $91.67 at 1 percent. This is 92 cents. The second month you will pay $8.33 plus the 92 cents interest, which is a total of $9.25. The payment is figured in this same way every month.

MONTHLY INTEREST RATE

Interest rates are often quoted at 1½ to 3½ percent per month. This sounds very cheap. But remember this is only for one month. The true annual interest rate is the quoted rate multiplied by 12. Interest at 1½ percent a month would be 18 percent per year, if the interest is paid at the end of each month.

Interest of 3½ percent a month equals *42 percent per year!*

ADD-ON INTEREST FOR INSTALLMENT BUYING

Here the interest is added to the loan. A $6.00 interest charge would be added to the $100, making a total of $106.

You make 12 equal payments. This sounds like 6 percent annual interest rate, but you are steadily paying off the principal loan. You will owe about $50 at the end of 6 months. But you will be paying interest on the full $100 when you make your last payment of $8.87. The true annual interest rate is 11.08 percent. This way, you pay interest on money you have already paid back.

INTEREST IN ADVANCE OR DISCOUNTED

Here the interest charge of $6 would be taken from $100. You would get $94. The true annual interest rate is 11.78 percent, if the loan is paid in 12 equal monthly installments.

Kinds of Credit

WHAT LOAN IS BEST FOR YOU?

You have learned to figure dollar cost and true annual interest rate. Compare the advantages and disadvantages of each type of loan.

You will want to consider things other than interest. Will there be hidden extras such as costs for late payments and credit life insurance?

Which should you choose? Your answer will depend upon your habits—how you handle money and how you plan to use it.

CHARGE ACCOUNTS

Regular charge accounts are used to buy goods and services. Stores let you buy and pay later. You may be asked to sign a sales slip each time you buy. Usually there is no charge for this kind of credit. With a regular charge account you are billed every 30 days. The bill is due then. There may be an interest or service charge if you do not pay in 30 days. This may be added to your original bill.

Stores with charge accounts may have higher prices to help cover the cost of this service. Some stores add a service or carrying charge to their charge accounts. Charge account regulations vary. Get all the facts about any particular one you plan to use.

Revolving charge accounts operate somewhat differently from regular charge accounts. You can charge only a limited amount. You and the store agree on the amount when you open the account. This limit is usually based on your income and credit rating. You pay a certain amount each month. You are charged interest on the unpaid balance. The rate is usually 1 to $1\frac{1}{2}$ percent a month.

INSTALLMENT PLAN

Usually installment buying is used to buy larger, more expensive equipment and furnishings. Furniture, television sets, and washing machines can be bought this way.

You sign a contract. You may make a down payment. Then you pay a set amount each week or month. The contract may be for a few months or several years. Finance and other special charges are added. You use the things while you pay for them. You do not own them until all payments are made.

Interest and other charges vary. Know exactly what you are paying. Be sure you understand the terms of the contract you sign. True rates are sometimes 15 to 20 percent. They can be even higher.

CASH LOANS

You can get cash loans from a lending agency. You will be asked to sign a legal contract. Sometimes security called "collateral" may be required. Often what you buy with the money can be used for collateral. Rates and ways of figuring interest will depend on where you get the loan. Loans may be repaid in regular weekly or monthly payments or paid in total at a given time.

Banks may use a "discount," "interest on unpaid balance," or "add-on" method. Usually interest on a personal installment loan is charged on the full amount of the loan until it is repaid. Banks sometimes state their rates at $5 or $6 (9 to 11 percent) on $100 a year. With enough collateral or security you may be able to get a lower rate.

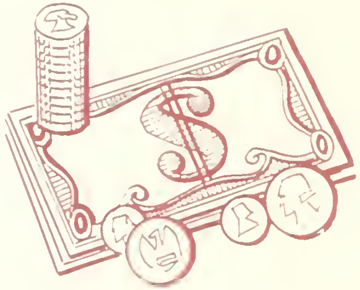
Credit Unions lend money to their members. Interest is stated as a monthly rate on the unpaid balance. Each credit union sets its own rate. They do not charge more than 1 percent a month. This would be a true annual interest rate of 12 percent.

Life Insurance Companies will make loans to policyholders. You can borrow up to the cash value of your policy. The policy serves as collateral. The interest rate is usually stated in the policy. Usually it's 4 to 6 percent simple interest. If you borrow on your insurance, you are reducing your protection.

Personal Finance or Small Loan Companies require less collateral than most other lending agencies. Interest rates and service charges are usually higher because they make small loans and take greater risks. The rate of interest companies can charge may be limited by State law. Rates are stated as a monthly rate on the unpaid balance of the loan. Usual true interest rates range from 12 to 42 percent per year.

Pawnshops charge very high rates. The annual rate could be 24 to 120 percent or more. You must leave something as collateral or security for the debt. The amount of the loan is small compared with the value of what you leave as security.

Illegal lenders' rates may be even higher than pawnshops. Such lenders often take advantage of the borrower. For your own protection, it will be better for you to borrow from a reliable lending agency.



How's Your Credit Rating?

Credit is based on the lender's faith in the borrower's ability to repay.

Use Credit Carefully and Wisely

It can be important to you and your family. A creditor wants to know—

- if you pay your bills on time
- how much you earn
- whether you have a steady income

He probably will telephone the local credit bureau. They will know if you pay your bills when due. Your credit record moves with you.

Application for Credit

You will fill out an application form. It will have such questions as:

- your full name, wife's or husband's name
- size of your family
- your address, how long you have lived there
- do you rent or own your home
- where you work and how long
- stores where you charge or buy on installment
- bank where you have savings or checking account
- names of close personal friends and relatives.

Lenders want to know these things before you can get credit.

These 6 C's Count for Credit

Character—a sincere attitude toward paying your bills.

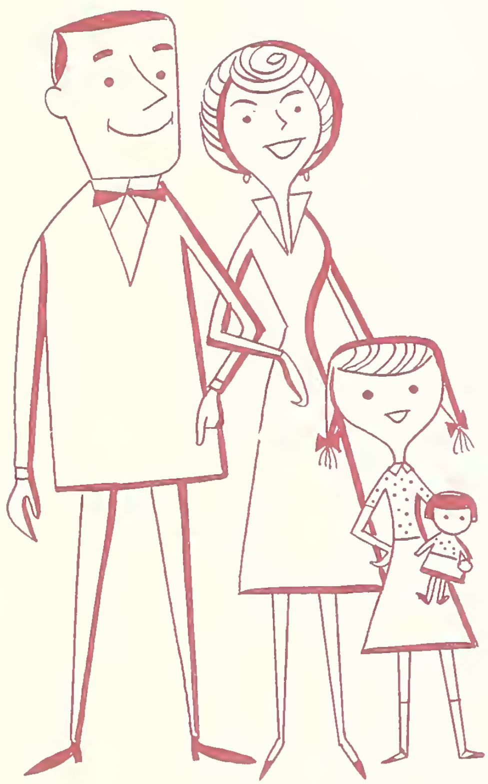
Capacity—ability to repay loan from money coming in.

Capital—owning property or things worth more than your debt.

Conditions—agreements made in advance between lender and person borrowing.

Collateral—the possessions of any kind, which are set aside or deposited as security for the debt.

Common Sense—ability to use credit wisely.



Protect Your Credit Rating

- Keep your promise to pay on time.
- Let your creditors know if you can't pay—before the payment is due.
- Explain why. Usually some other agreement can be made.

Remember . . .
When You Use Credit --

- make sure advantages outweigh the disadvantages
- follow the rules to have a good credit rating
- learn about the different kinds of credit
- shop for credit—get it at the lowest possible cost
- decide the best kind for your purpose
- understand the terms of any contract you sign.

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